

## BEFORE THE STATE BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of ) GRADY AND INEZ FARRINGTON LOUIS VAN CRDER

Apparances:

or Appellants: Baxter K. Richardson, Attorney at Law For Respondent: Wilbur F. Lavelle, Assistant Counsel Baxter K. Richardson, Attorney at Law

OPINION

CAThese appeals are made pursuant to Section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Grady and Inez Farrington in the amounts of \$55.01 and \$1,512.87 for the years 1954 and 1955, respectively, and against Louis Van Order in the amounts of \$39.33 and \$2,147.48 for the years 1954 and 1955, respectively. The assessment of \$39.33 against Louis Van Order for 1954 includes a penalty of \$7.87 for failure to file a timely return. It is undisputed that this penalty is proper if the amount of tax is correct.

Appellants Inez Farrington and Louis Van Order were partners in the Van Amusements Company. Van Amusements operated a coin-machine business in and near Fresno. It owned multiple-or bingo pinball machines, bingo pinball machines without multiple-odd features, flipper pinball machines, music machines and some It owned multiple-odd other types of amusement machines. The equipment was placed in restaurants, taverns and other locations. The net proceeds from each machine, after the allowance of certain expenses claimed by the location owner in connection with the machine, were divided equally between Van Amusements and the location owner.

The business was started in June of 1954. Amusements owned only six machines but gradually more were acquired until by the end of 1955 it owned 50 machines.

The gross income reported in the tax returns of Van Amusements was the total of amounts retained by it from locations. Deductions were taken for depreciation, interest, rent, salaries, entertainment and other business expenses.

Respondent determined that Van Amusements was renting space in the locations where its machines were placed and that all the

coins deposited in the machines constituted gross income to Van Amusements. Respondent also disallowed all expenses pursuant to Section 17359 (now 17297) of the Revenue and Taxation Code which read:

In computing net income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

As we held in Appeal of C. B. Hall, Sr., Cal. St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par, 201-197, 3 P-H State & Local Tax Serv. Cal. Par. 58145, if a coin machine is a game of chance and cash is paid to winning players, the operator is engaged in an illegal activity within the meaning of Section 17359. The multiple-odd bingo pinball machines here involved are substantially identical to the machines which we held to be games of chance in Hall.

The evidence as to cash payouts to players of bingo pinball machines for free games not played off is in conflict. Appellant Inez Farrington testified that in making collections she often accompanied Appellant Louis Van Order and assisted him. She further testified that the entire proceeds of each machine was divided 50% for the location owner and 50% for Van Amusements, that occasionally a location owner would claim a small amount, "20¢," "40¢" or "maybe a dollar" for refunds to players due to malfunction of a machine and that no location owner claimed expenses for cash payouts made to players of the pinball machines for free games not played off, Appellant Louis Van Order testified that he made most of the collections, that the proceeds of the machines were always divided 50% to the location owner and 50% to Van Amusements, that at times location owners asserted claims for expenses for cash payouts to players for free games not played off, but that he always refused to honor such claims. location owner who indicated that he was quite friendly with Appellants testified that he had their pinball machines, that at least one of them was a multiple-odd machine and that, although often requested to do so by players, he never made cash payouts for free games not played off.

Apparently somewhat less than half of the machines were in locations in the City of Fresno. The city ordinance required that each pinball machine be licensed and prohibited any pinball

machine having a multiple-odd feature. Most of the machines of Van Amusements on location in the city were of a kind known as Bally Beauty. These were three-card 'bingo pinball machines in which'the player could insert from one to three nickels to play from one to three cards, respectively. Five balls were played and free games could be won for a given winning combination on any of the cards being played.

As originally manufactured, a Bally Beauty had a multiple-odd feature, that is, additional coins could be inserted to increase the number of free games won for a given winning combination. However, Van Amusements removed the multiple-odd feature on all machines placed on location in the City of Fresno, The locations not in the City of Fresno were elsewhere in Fresno County and many of the pinball machines in these locations were of the multiple-odd bingo type.

Two location owners testified that they had bingo pinball machines from Van Amusements, that they made cash payouts to players for free games not played off, that they asserted claims against Van Amusements for the amounts of the payouts, that their claims were honored from the proceeds in the machine and that the balance was divided equally with Van Amusements. The place of business of one of these location owners was in the City of Fresno and that of the other was outside the City of Fresno.

The location owners who testified that they made cash payouts and were reimbursed from the proceeds in the machines were the only witnesses who were indifferent to the result reached by us. For this reason we feel that their testimony is reliable and must be accepted as the truth. Their testimony refutes the testimony of Appellants that location owners were never allowed reimbursement from the proceeds of the machines for cash payouts to players for free games not played off,

We must next decide whether the practice of making such cash payouts was general among location owners. Since Appellants were in the best position to know if only a few of the location owners asserted claims for such cash payouts and they failed to testify to that effect, we conclude that it was the general practice of location owners having bingo pinball machines with or without the multiple-odd feature to make cash payouts for free games not played off.

The evidence indicates that the operating arrangements between Van Amusements and each location owner were the same as those considered by us in the <u>Hall</u> appeal, supra. Our conclusion in <u>Hall</u> that the machine owner and each location owner were engaged in a joint venture in the operation of the machines is, accordingly, applicable here.

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Since the multiple-odd bingo pinball machines were games of chance and cash was paid to winning players, these machines were operated illegally and Respondent was correct in applying Section 17359.

Approximately half of the machines owned by Van Amusements were multiple-odd bingo pinball machines. The entire operation as to all machines was conducted as one business. Appellant Louis Van Order made collections from all machines and, as needed, made repairs to all types of machines. Therefore, there was a substantial connection among the illegal operation of multiple-odd pinball machines, the operation of bingo pinball machines without multiple-odd features and the legal operation of music and other amusement machines. Respondent was thus correct in disallowing all deductions for expenses of the entire business. It is not necessary to this decision to determine whether bingo pinball machines without multiple-odd features are games of chance so that it would be illegal to make cash payouts to players of such machines for free games not played off.

There were no records indicating the fact of or the amount of cash payouts for free games not played off. Based on the estimate of one location owner, Respondent computed the amount of such cash payouts on the assumption that they equalled 60% of the entire amounts deposited in the machines and that such cash payouts were made on all types of machines owned by Van Amusements except music machines, the income from which was separately recorded.

As we held in Hall, supra, Respondent's computation of gross income is presumptively correct. In the absence of records or other reliable evidence, Respondent's method was reasonable and we, therefore, sustain the 60% payout determination.

Because records of income from each type of machine were not available, Respondent assumed that cash payouts were made on all types of machines except music machines. While it is possible that this assumption is not correct, we believe that it is up to Appellants to produce a credible basis for a more accurate allocation. This they have not done.

Except for the reduction due to our conclusion that Van Amusements and each location owner were engaged in a joint venture, Respondent's computation of gross income is sustained.

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## ORDER

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 18595 of the Revenue and Taxation Code that the action of the Franchise Tax Board on protests to proposed assessments of additional personal income tax against Grady and Inez Farrington in the amounts of \$55.01 and \$1,512.87 for the years 1954 and 1955, respectively, and against Louis Van Crder in the amounts of \$39.33 and \$2,147.48 for the years 1954 and 1955, respectively, be and the same is hereby modified in that the gross income is to be recomputed in accordance with the Opinion of the Board. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 6th day of November, 1961, by the State Board of Equalization.

	John W. Lynch	, Chairman
	Paul R. Leake	, Member
	Geo. R. Reilly	, Member
		, Member
		, Member
ATTEST: <u>Dixwell L. Pierce</u>	, Secretary	